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Prime Minister ②
To be aware. DTI
make out a good case AT 28/3
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Secretary of State for Trade and Industry

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27 March 1984

The Rt Hon Nigel Lawson MP
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D Nigel,

CAPITAL ALLOWANCES: TRANSITIONAL ARRANGEMENTS FOR CERTAIN REGIONAL PROJECTS

Despite our efforts to devise arrangements which would protect the Nissan project from the short-term consequences of the withdrawal of capital allowances and which would minimise the risk of challenge by the Commission, the Commission have informed us that they regard the arrangements as constituting regional aid. The Commission are therefore arguing that the arrangements are a notifiable aid and must not be put into effect until the Commission have assessed their capability with the Common Market. ... A copy of the telegram is attached.

2 The Commission's challenge is somewhat surprising in that the UK's system of capital allowances and changes in that system have not been challenged in the past. On the other hand, I am informed by my legal advisers that because Article 93 of the Treaty of Rome is drawn so widely, transitional tax measures could constitute a notifiable aid.

3 Whatever the strictly legal argument, I believe there is only one course open to us if we are to honour our commitment to Nissan and safeguard the project. We have no alternative but to contest the Commission's interpretation by arguing that the transitional arrangements do not constitute the granting of an aid and are not therefore notifiable. The transitional arrangements announced in the Budget remain our best hope of avoiding successful challenge by the Commission: we could not even begin to defend measures which were specific to Nissan and/or of an expenditure nature. If we were to notify it is likely that the Commission would allow the transitional arrangements to proceed; although in the current climate this cannot be certain. But we would then have to include the 'benefit' of these arrangements in the assistance calculations for each of the projects affected. For Nissan this would push the level of 'assistance' well above the Commission's permitted level of 'net grant equivalent' and thus kill the project.

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4 There are several arguments we can use in defence of the line that the transitional arrangements do not constitute a grant of aid and are not therefore notifiable. but I believe that we stand the best chance of stopping this proceeding beyond officials in DGIV if we combine a firm but short response to the letter from the Director of DGIV with a low-key and informal delivery. I would therefore propose that our Counsellor (Industry) in Brussels personally delivers the reply, the nub of which would be:

"We do not regard a tax measure which is designed to reduce the pre-Budget regime of capital incentives to UK companies through the withdrawal of capital allowances as constituting an aid and therefore as notifiable."

The Counsellor could explain some of our broad reasoning behind this view in an attempt to keep the exchange as informal as possible.

5 If the Commission pursue the matter, we would use the following arguments:

i) We are not granting an aid to the projects covered by the transitional arrangements. They will simply continue to receive, for a very limited period of time, the pre-Budget level of capital allowances, which have never been challenged as constituting an aid.

ii) There is not any geographically differentiated rate of capital allowances. The new structure of corporation tax will apply nationally.

iii) The announced proposals are purely transitional arrangements to move from the current structure of corporation tax to the new structure.

iv) None of the projects which will be covered by the transitional arrangements will receive anything additional to that which was negotiated and which was within the EC rules. It is simply that the current tax system, on which these projects were negotiated, will continue to apply in these cases, for the limited number of years over which specific and committed capital expenditure will take place. The Government is honouring its commitments.

v) In similar vein, the Chancellor has also announced that the existing rates of capital allowances will apply to future expenditure (as long as it is expended within three years) which, by Budget day, was contractually committed.

6 If you agree with this course of action I will ask my officials (in conjunction with yours) to brief Counsellor

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(Industry) with a view to responding to the Commission later this week.

7 I am copying this letter to the Prime Minister and the Foreign Secretary.

Norman

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